
**ESTABLISHING A U.S. INTERNATIONAL DEVELOPMENT FINANCE CORPORATION
OFFICE IN THE SOUTH CAUCASUS REGION**

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I. EXECUTIVE SUMMARY

The Biden Administration has emphasized its eagerness to reassert U.S. global leadership and repair its fractured diplomatic ties around the world, and the South Caucasus region is proving to be a critical region for this initiative. President Biden has underscored that American leadership must address several challenges, including the “growing ambitions of China to rival the United States and the determination of Russia to damage and disrupt” democracy.¹ U.S. Secretary of State Anthony Blinken has stressed that the “world looks very different than it did decades ago, when we forged many of our alliances” as threats multiply, competition stiffens, and power dynamics shift.²

Russia, in particular, presents a proven and growing threat to stability in the South Caucasus region, as recent events clearly demonstrate. Despite extensive diplomatic efforts, Russia launched a large-scale military invasion of Ukraine on February 24, 2022, marking a major escalation to Russia’s 2014 annexation of Crimea,³ and drawing parallels to the 2008 war with Georgia. The current scenario is a repetition of the Kremlin’s historical playbook. Before February 2022, the West failed to respond effectively to the Russian threat, and now the United States and its allies are reacting to Russia’s full-scale invasion.⁴

This white paper outlines one segment of a two-pronged affirmative approach to deterring Moscow and other geopolitical and economic adversaries in the South Caucasus region

¹ Remarks by President Biden on America’s Place in the World (Feb. 4, 2021), THE WHITE HOUSE, available at <https://www.whitehouse.gov/briefing-room/speeches-remarks/2021/02/04/remarks-by-president-biden-on-americas-place-in-the-world/>.

² Reaffirming and Reimagining America’s Alliances – Speech by Secretary Blinken at NATO Headquarters (Mar. 24, 2021), available at <https://ru.usembassy.gov/reaffirming-and-reimagining-americas-alliances-speech-by-secretary-blinken-at-nato-headquarters/>.

³ Ukraine’s Foreign Minister Says Kyiv Struck by ‘Horrific Russian Rocket Strikes,’ CNBC (Feb. 25, 2022), available at <https://www.cnbc.com/2022/02/24/ukraine-russia-news-vladimir-putin-orders-attack-as-explosions-are-reported.html>.

⁴ FACT SHEET: Joined by Allies and Partners, the United States Imposes Devastating Costs on Russia (Feb. 24, 2022), available at <https://www.whitehouse.gov/briefing-room/statements-releases/2022/02/24/fact-sheet-joined-by-allies-and-partners-the-united-states-imposes-devastating-costs-on-russia/>.

and reasserting U.S. leadership in the key geopolitical crossroads and international transit hub located between Russia and Turkey, as well as the Caspian and the Black Seas.

U.S. interests in the South Caucasus region

The United States has important interests in the South Caucasus, which include preserving regional stability; preventing the resumption of frozen conflicts; and supporting democratic change and better governance as well as the international integration of Armenia, Azerbaijan, and Georgia. U.S. regional interests extend beyond the immediate borders of the South Caucasus, and nearby conflict areas could threaten Turkey and other NATO allies in the Black Sea region. Military conflict and general destabilization of the South Caucasus could support attempts to return the region to Russia's sphere of influence.

Recent events— Russia's full-scale invasion of Ukraine, the breakdown of the post–Cold War European security order, changing global energy markets, instability to the region's south, a relatively new U.S. administration, and the European Union's internal challenges— call for sustained U.S. engagement to advance these many interests.

Further, the United States has an interest in disrupting China's efforts to take advantage of the Ukraine-Russia conflict through closer engagement with Central Asia. China's growing demand for natural gas has led to an agreement to restart an unfinished project to drill new wells in Turkmenistan's giant Galkynysh gas field, which is ranked as one of the five largest in the world.⁵ Chinese resource investments in Central Asia already include its hydrocarbon investments in Kazakhstan and Turkmenistan, mining interests in Kyrgyzstan and Afghanistan, and potential agricultural investments throughout the region.⁶ These developments reflect a declining U.S. presence in and influence over the broader region and portend a greater difficulty

⁵ China's Gas Shortage Boosts Central Asia's Role (Sept. 10, 2021), available at https://www.rfa.org/english/commentaries/energy_watch/gas-09102021120739.html.

⁶ Thornton, Susan A. China in Central Asia: Is China Winning the "Great New Game" (Jun. 2020), available at https://www.brookings.edu/wp-content/uploads/2020/06/FP_20200615_china_central_asia_thornton.pdf.

in transforming Central Asian and South Caucasus states into democratic, free-market economies.

A two-pronged long-term approach

The establishment of a permanent U.S. International Development Finance Corporation (“DFC”) office in the South Caucasus is a crucial step toward reinforcing U.S. commitments in the region and toward countering geopolitical and economic influence by U.S. adversaries. Russia, China, and other competitors also recognize the importance of this region and are investing heavily. The South Caucasus region is a crossroads of oil and gas pipelines that diversify energy supplies to the several European states, thereby reducing their dependence on Russian energy exports.⁷ This region is also essential for China’s “Belt and Road” Initiative (“BRI”).⁸ The existing and proposed trade and communication routes are of significant importance, providing transport corridors which connect the Central Asian states and China to Europe.⁹

This paper reviews the U.S. approach to challenges by systemic adversaries in the South Caucasus, and how a permanent DFC office in the South Caucasus can help advance U.S. policy in this region on the Russian frontier and as a historic gateway to the Caucasus and Central Asia [and to the Middle East]. In doing so, the United States can displace competing and adverse interests by offering a better alternative through transparent and sustainable financing that:

⁷ The Policy of the United States in the South Caucasus (May 14, 2019), available at <https://euro-sd.com/2019/05/articles/13228/the-policy-of-the-united-states-in-the-south-caucasus/>.

⁸ South Caucasus and Central Asia: The Belt and Road Initiative Georgia Country Case Study (Jun. 2020), available at <https://openknowledge.worldbank.org/bitstream/handle/10986/34122/South-Caucasus-and-Central-Asia-The-Belt-and-Road-Initiative-Georgia-Country-Case-Study.pdf?sequence=4&isAllowed=y>; South Caucasus and Central Asia: The Belt and Road Initiative Armenia Country Case Study (June. 2020), available at <https://openknowledge.worldbank.org/bitstream/handle/10986/34120/South-Caucasus-and-Central-Asia-The-Belt-and-Road-Initiative-Armenia-Country-Case-Study.pdf?sequence=4&isAllowed=y>; South Caucasus and Central Asia: Belt and Road Initiative Azerbaijan Country Case Study (Jun. 2020), available at <https://openknowledge.worldbank.org/bitstream/handle/10986/34329/South-Caucasus-and-Central-Asia-The-Belt-and-Road-Initiative-Azerbaijan-Country-Case-Study.pdf?sequence=5&isAllowed=y>.

⁹ *Id.*

- sources bankable deals in the entire region through a permanent and visible U.S. presence in the region;
- attracts U.S. investment and private sector engagement;
- reduces vulnerability to China's debt-trap diplomacy and starves corruption incentives; and
- upholds and promotes high labor, environmental, good governance, and transparency standards.

Of the three South Caucasus states, Georgia is the most attractive destination for a regional DFC office. Armenia, which has grown increasingly dependent on Russia, has exhibited a willingness to participate in Russia's missions in Syria and more recently, Kazakhstan¹⁰ as an integral part of perceived efforts to restore the Soviet Union's former borders.¹¹ Russia's closest relationship in the South Caucasus remains with Armenia, the country most firmly entrenched in Russia's camp.¹² Azerbaijan maintains close relations with China and Turkey.¹³ Given the competing ambitions of different countries with regard to the South Caucasus, a DFC office in Georgia, in particular, would confirm U.S. regional commitment to Western values through economic partnership.

¹⁰ Russia-Led Bloc Starts Kazakhstan Pullout After Possible Coup Bid Crushed (Jan. 13, 2022), REUTERS ("Russia-Led Bloc"), available at <https://www.reuters.com/world/asia-pacific/russia-led-bloc-starts-pulling-troops-out-kazakhstan-2022-01-13/>. Kazakh President Kassym-Jomart Tokayev asked for assistance from the Russia-led military bloc, prompting Secretary Blinken to seek answers on why they needed to call in Russian-led security forces to resolve domestic unrest. U.S. Seeks Answers from Kazakhstan on Need for Russian-Led Troops (Jan. 9, 2022), available at <https://www.reuters.com/world/us-seeks-answers-kazakhstan-need-russian-led-troops-2022-01-09/>.

¹¹ Armenia as a Mere Pawn in Russia's Kazakhstan Strategy (Jan. 17, 2022), available at <https://neweasterneurope.eu/2022/01/17/armenia-as-a-mere-pawn-in-russias-kazakhstan-strategy/>.

¹² Armenia Stands Alone in Support for Russia in Council of Europe (Feb. 26, 2022), available at <https://oc-media.org/armenia-stands-alone-in-support-for-russia-in-council-of-europe/>; *see also* Armenia Announces Truce With Azerbaijan After Deadly Clashes (Nov. 17, 2021), available at <https://www.rferl.org/a/armenia-russia-defense-azerbaijan/31564269.html>.

¹³ Russia's Stony Path in the South Caucasus (Oct. 20, 2020), available at <https://carnegieendowment.org/2020/10/20/russia-s-stony-path-in-south-caucasus-pub-82993>.

A second prong to the proposed affirmative approach, as outlined separately, would involve a bilateral free trade agreement between the United States and Georgia, which would serve to further a decade-long trade dialogue and strengthen an already-positive trade relationship in an emerging regional market.

II. A DFC OFFICE IN THE SOUTH CAUCASUS WOULD ADVANCE U.S. GEOPOLITICAL, ECONOMIC, AND POLICY INTERESTS

A. *Introduction*

“Now is the time when things are shifting and there is going to be a new world order out there, and we’ve got to lead it. We’ve got to unite the rest of the free world in doing it.”¹⁴

President Joe Biden, March 21, 2022

The establishment of a permanent DFC office in Georgia will be an important step by the United States to lead the free world at this inflection point in the world economy to expand and consolidate a Build Back Better World in collaboration with the European Union and NATO partner nations. In the context of the emerging world order that President Biden signaled, DFC’s product lines are uniquely suited to provide additive value to collaborative efforts with European Union Development Credit Institutions. In addition to DFC’s debt and equity products, political risk insurance can additionally be deployed in support of offerings on U.S. Capital markets to leverage critical investments.

In the face of Russia’s naked territorial aggression against its neighbors, the countries of the Caucuses and Central Asia and Eastern Europe are looking to the United States and the West to support regional economic independence and sovereignty. A regional DFC Office would

¹⁴ Remarks by President Biden Before Business Roundtable’s CEO Quarterly Meeting (Mar. 21, 2022), <https://www.whitehouse.gov/briefing-room/speeches-remarks/2022/03/21/remarks-by-president-biden-before-business-roundtables-ceo-quarterly-meeting/>.

reinforce regional economic integration and links to Europe and the U.S. which, in turn, can reinforce reforms to privatize state assets, which have become a geopolitical playground as Chinese and Russian investors jockey for ownership and pervasive influence.¹⁵ For example, in 2020, the Georgian government recognized that it would “have to make concrete decisions regarding state-owned companies,”¹⁶ where corruption has been the norm.¹⁷

There are varying levels of interest and commitment to the privatization of state-owned enterprises (“SOEs”) ranging from relative openness in Georgia and Uzbekistan to nonexistent in Turkmenistan. The Republic of Georgia announced plans for the privatization of SOEs through 2024 beginning with the Georgian State Electrosystem, an electricity transmission system operator. In 2019, Uzbekistan announced the privatization of 64 SOEs from the financial, construction, oil and gas, food and alcohol production, chemical and power sectors. Consolidating and expanding privatization plans for SOEs is provides a significant development opportunity for a regional DFC office in Tbilisi.¹⁸

Russia’s aggression in Ukraine underscores the need for greater integration and interdependence among the nations of the Caucuses and Central Asia. Facing this common threat presents an opportunity for DFC and other development finance institutions (“DFIs”) to leverage Western investment to reinforce regional economic cohesion and resilience as well important reforms. A regional DFC office would allow DFC to increase deal flow and leverage market-oriented reforms.

¹⁵ AGENDA.GE, Georgian gov’t to begin reforming state-owned enterprises in 2021-2024 (Jan. 2021), <https://agenda.ge/en/news/2021/228>.

¹⁶ AGENDA.GE, Acting PM Ghakaria: Georgia should plan privatization of several state-owned companies (Dec. 2020), <https://agenda.ge/en/news/2020/4002>.

¹⁷ PRACTICAL ECONOMICS: ECONOMIC TRANSFORMATION AND GOVERNMENT REFORM IN GEORGIA 2004-2012 2017 at 113 -115, GILAURO Nika, available at <https://link.springer.com/content/pdf/10.1007%2F978-3-319-45769-7.pdf>.

¹⁸ Uzbekistan Privatizes Certain State Companies, Investment Policy Hub (Apr. 29, 2019), <https://investmentpolicy.unctad.org/investment-policy-monitor/measures/3387/uzbekistan-uzbekistan-privatizes-certain-state-companies>; AGENDA.GE, Georgian gov’t to begin reforming state-owned enterprises in 2021-2024 (Jan. 2021), <https://agenda.ge/en/news/2021/228>.

DFC and collective DFI investment standards will help leverage “soft investments,” such as “...regulations, transparency, irregular payments, favoritism, and measures to combat corruption.”¹⁹

DFC has struggled to source bankable private sector deals in a region that remains heavily invested in SOEs. Low levels of domestic credit to the private sector in many countries of this region hinder economic development and regional integration. DFC has a track record of leveraging domestic credit in the region, an area that will require both capital and reforms.

There is evidence that establishing a regional DFC office can substantially increase deal flow. For example, in 2015, the European Investment Bank (“EIB”) booked \$519 million in investments in the region. After opening an office in Tbilisi in 2016, the EIB had more than tripled its investment bookings to \$1.57 billion in 2019.²⁰ There was a decrease thereafter of investment bookings due to the global pandemic, but the value of the investments booked would still have more than offset the cost of opening the EIB office.

The significant political risk created in the region by Russia’s invasion of Ukraine will linger beyond the end of the conflict. DFC’s political risk insurance tool can make the difference for U.S. and other western investors’ decision making. A number of Western companies are relocating from Russia to the region, in particular to Tbilisi, and are looking for DFC risk insurance. Specifically, companies in the energy, logistics, and information technology sectors are looking to move their operations to Tbilisi. Chevron, for example, is working on relocating their operations to Georgia from Russian ports for chemical products, oil and petroleum-based products produced in Kazakhstan. American IT companies, such as Boston-based Quantori, who had offices in Russia and Belarus is relocating its offices to Georgia.

¹⁹ Ghulam Samad and Qaisar Abbas, “Infrastructure in Central Asia and Caucasasia,” ADBI Working Paper Series (Dec. 2020), available at <https://www.adb.org/sites/default/files/publication/660631/adbi-wp1202.pdf>.

²⁰ See Attachment, DFI Investment Statistics.

In the current context of the comprehensive international sanction regime, the Caucasus and Central Asia need a trade corridor to the West that is independent of Russia and avoids entanglements with Iran. The Republic of Georgia is the geographic anchor on the Black Sea for this trade corridor that stretches to the Central Asia's borders with China and Russia.

During the course of NATO's engagement in Afghanistan, this transportation corridor was used and developed by local contractors to supply our presence in Afghanistan. These transportation links, which were reinforced by the U.S., remain in place and are commercially viable. For example, Trammo, a major U.S. commodities trader, has invested in a transfer facility at the Port of Batumi that is sourcing fertilizer inputs. High quality infrastructure in roads, rail transportation, shipping and ports will be needed to develop this transportation corridor. DFC has already made strategic investments including at the Port of Poti in support of this trade corridor.

The European Commission, the executive arm of the EU, wants to cease its buying of fossil fuels from Russia before 2030. And it has now presented a new pledge to reduce its purchases of Russian gas by two-thirds before the end of the year.²¹ This decision is a game changer and highlights the need for quality infrastructure investments to increase the capacity of the Central Asia to Georgia trade corridor. In this light, the following prospective projects can help the West to achieve this goal.²²

²¹ Silvia Amaro, "EU Pledges to Cut Russian Gas Imports by Two-Thirds Before the End of the Year," CNBC (Mar. 8, 2022), <https://www.cnbc.com/2022/03/08/eu-pledges-to-cut-russian-gas-imports-by-two-thirds-before-next-winter.html>.

²² Michael Furman, European Union Keen on Trans-Caspian Pipeline Development – Improvement of Relations with Russia and Turkey a Key Hurdle, Mitsui & Co. Global Strategic Studies Institute Monthly Report (Nov. 2019), available at https://www.mitsui.com/mgssi/en/report/detail/_icsFiles/afieldfile/2020/01/31/1911e_fuhrmann_e.pdf; "Azerbaijan, Turkmenistan Finally Reach Deal On Lucrative Caspian Sea Energy Field," Radio Free Europe / Radio Liberty (Jan. 21, 2021), <https://www.rferl.org/a/azerbaijan-turkmenistan-deal-caspian-energy-field-dostluq-31061674.html>; "Trans-Caspian Pipeline and White Stream Projects," Georgian Oil & Gas Corporation, available at <https://www.gogc.ge/en/project/trans-caspian-pipeline-and-white-stream-projects/33>.

- Trans Caspian Pipeline project
- White Stream Project
- Georgian-Romanian Black Sea Submarine Transmission Line project
- Anaklia deep seaport
- New rolling stock for Georgian, Azerbaijan, Turkmenistan, Uzbekistan Railways
- New port capacities in Azerbaijan, Turkmenistan, Kazakhstan

Central Asian and Caucasian regions are lagging substantially behind in financing their infrastructure needs. A substantial amount of financing, \$26 trillion for 2016–2030 or \$1.7 trillion per year, is required to sustain growth and improve people’s livelihoods.²³ Other quality infrastructure investment opportunities include electrical transmission linking Georgia with its neighbors and, in turn, with the European Union. This will reinforce regional interdependence and reduce reliance on Russia. Other highly developmental areas for investment include water and sanitation, sustainable agriculture, telecommunications, and the digital economy. Central Asia is a significant source of critical minerals: 38.6% of global manganese ore reserves, 30.07% of chromium, 20% of lead, 12.6% of zinc, 8.7% of titanium, 5.8% of aluminum, 5.3% of copper, 5.3% of cobalt, and 5.2% of molybdenum.

Proven natural gas reserves in the region of 230 to 360 trillion cubic feet represent about 7% of total world proven gas reserves.²⁴ In the context of the need to secure alternatives to Russian oil and gas for Europe, Central Asia and the Caucasus and its trade corridor to the West will require significant infrastructure expansion and integration investments. BlackRock sees an end to globalization and a move to national and near shore production. “Russia’s aggression in Ukraine and its subsequent decoupling from the global economy is going to prompt companies and governments worldwide to re-evaluate their dependencies and re-analyze their manufacturing and assembly footprints — something that Covid had already spurred many to

²³ Ghulam Samad and Qaisar Abbas, “Infrastructure in Central Asia and Caucasia,” ADBI Working Paper Series (Dec. 2020), available at <https://www.adb.org/sites/default/files/publication/660631/adbi-wp1202.pdf>.

²⁴ Amy Myers Jaffe, “Unlocking the Assets: Energy and the Future of Central Asia and the Caucasus,” (Apr. 1998), available at <http://www.amymyersjaffe.com/content/pdf/CASPIANMAIN%20STUDYunlocking-the-assets-energy-and-the-future-of-central-asia-and-the-caucasus-working-papers.pdf>.

start doing. The recognition of these negative aspects of globalization has now caused the pendulum to swing back to local sourcing. Rather than the cheapest, easiest, and greenest sources, there'll probably be more of a premium put on the safest and surest.”²⁵ In this context, having a DFC regional office in Georgia (and providing insurance to the American companies) means significantly increased foreign direct investment (“FDI”) from the US in South Caucasus and Central Asia.

The Republic of Georgia has the most sophisticated domestic financial markets in the region. Credit to the private sector as a percentage of GDP increased from a low of 32.33% in 2010 to 79.87% in 2020. Georgia, with a score of 71.8, is the highest ranked country in the region in the Heritage Foundation’s index of economic freedom.

The EIB, the World Bank International Finance Corporation (“IFC”), Germany’s eutsche Gesellschaft für Internationale Zusammenarbeit and KfW, the French Development Agency (AFD), and other international financial institutions have permanent offices in Tbilisi. There are direct flights to major cities in the Caucuses, Central Asia, Europe and the Middle East from Tbilisi.

The policy framework provided by a DFC office would balance power and reassert U.S. economic and diplomatic leadership in the region, while providing the proper safeguards against corruption through independence and transparency.

B. *The Geopolitical Impact Of A Regional DFC Office*

The establishment of a permanent DFC office in Georgia would reaffirm the long-term U.S. commitment to, and partnership with, the region as a symbol of solidarity to: underscore that the United States is invested in regional success; reassert U.S. leadership, ownership, and influence as Georgia privatizes state-owned assets; counter political interference by Russia,

²⁵ “Wall Street Warns About the End of Globalization,” New York Times (Mar. 24, 2022), available at <https://www.nytimes.com/2022/03/24/business/dealbook/globalization-fink-marks.html>.

Turkey, and China as the region develops as a transit hub suitable for facilitating Russia's energy objectives and China's BRI; and develop a stronger and more reliable relationship with vital Black Sea regional partners.

In addition, the establishment of a permanent DFC office would not only serve to maintain a balance of power in Europe and Asia that promotes peace and stability with a continuing U.S. leadership role in a key location between Europe and Asia, two major rivals (Russia and Iran), conflict zones (Iraq and Syria) and an unpredictable Turkey; and but also to ensure South Caucasus countries' continued cooperation with U.S.-led alliances, such as NATO.

Further, a regional DFC office would support U.S. allies' economic resilience and their active cooperation with the United States in shaping an international system consistent with U.S. interests. In particular, a regional office would facilitate U.S. influence relative to regional and domestic reform and order consistent with U.S. foreign policy objectives.

A U.S. presence in the region is imperative. Notably, misplaced reliance by the West on the Minsk Group format during the Nagorno-Karabakh facilitated the exertion of geopolitical influence by Moscow and Ankara.²⁶ Now, through the establishment of a DFC office, the United States has an opportunity for increased diplomatic and economic engagement by carefully integrating its foreign policy in the region with its policies on Georgia, Turkey, and Russia.

Reasserting a U.S. leadership role should be a priority, as should be maintaining the South Caucasus countries' cooperation with U.S.-led alliances, such as NATO. Georgia, for example, provided the third-largest contingent of troops for the war in Iraq behind only the U.S. and Great Britain and was the largest non-NATO troop contributor to the war in Afghanistan.²⁷

²⁶ Short-sighted U.S. Foreign Policy in the South Caucasus in a New Geopolitical Environment (Jul. 22, 2021), available at <https://thegeopolitics.com/short-sighted-us-foreign-policy-in-the-south-caucasus-in-a-new-geopolitical-environment/>.

²⁷ See RUSSIA MATTERS.

Armenia, meanwhile, sent peacekeepers and a demining battalion to Iraq.²⁸ An influx of alternative investment sources could disrupt these partnerships and support American influence in the region.

C. *Quantifying The Potential Benefits Of A Regional DFC Office*

While China, Russia, Turkey, and other influencers seek to take advantage of investment opportunities in the South Caucasus region, a regional DFC office would serve to strengthen an already positive trade and investment relationship with the region in several respects. Two-way goods trade between the United States and the South Caucasus region totaled \$1.4 billion in 2019.²⁹ Investment flows to and from the region remain strong due to Bilateral Investment Treaties between the United States and all three countries.³⁰ Additionally, the United States and Georgia established a high-level dialogue on trade and investment in January 2012, and the United States and Armenia signed a Trade and Investment Framework Agreement in May 2015, both of which provide fora to address economic issues.³¹

First, a regional DFC office would support averting the resumption of regional conflicts. Preventing any one of the region's frozen conflicts from escalating into hostilities should remain the top priority for U.S. policy in the South Caucasus. The brief resumption of hostilities last year between Azerbaijan and Armenia highlighted the danger these conflicts pose to regional security and U.S. interests.

Second, U.S. interests in energy diplomacy would benefit from U.S. engagement in the South Caucasus. The South Caucasus transportation corridor extends all the way across Georgia and through Turkey to the eastern Mediterranean, and thus benefits the South Caucasus states

²⁸ *Id.*

²⁹ Caucasus Region, Office of the U.S. Trade Representative, available at <https://ustr.gov/countries-regions/europe-middle-east/russia-and-eurasia/caucasus-region>.

³⁰ *Id.*

³¹ *Id.*

and enhances Turkey's strategic importance in the South Caucasus and in Europe as the energy hub between the East and the West. Sustained DFC investments to the transport corridor would enhance not only the economic development of the South Caucasus states but also would help secure their independence from Russia by hedging against Moscow's monopolistic grip on Caspian energy exports.

Moreover, a regional DFC office could facilitate the development of critical infrastructure to separate Central Asia from its dependence on the Russian energy grid.³² In particular, the proposed Trans-Caspian Gas Pipeline ("TCGP") is the necessary link connecting Turkmen gas with the existing South Caucasus Pipeline (*i.e.*, the first building block of the Southern Gas Corridor or "SGC").³³ The planned TCGP would source natural gas onshore in Turkmenistan for transmission under the Caspian Sea and insertion into the SGC.³⁴ Kazakhstan and Uzbekistan joining Turkmenistan in trans-Caspian energy projects would connect them strategically to the West and reduce dependence on Russia's network. Further, Kyrgyzstan and Tajikistan are mountainous countries that have long been touted for their hydropower potential, which underscores opportunities in connection with Georgia's hydropower infrastructure.³⁵

Third, a regional DFC office would serve as a counterweight to China's significant bilateral efforts in the region. For example, China has signed a free trade agreement with Georgia. With the China-Georgia agreement entering into force Georgia has eliminated tariffs

³² The power grids of Kyrgyzstan, Uzbekistan, and Kazakhstan are interconnected and linked to Russia's network via a Soviet-build power line that runs through Kazakhstan. Central Asia blackout leaves millions without power (Jan. 25, 2022), BBC, available at <https://www.bbc.com/news/world-asia-60123178>.

³³ US foreign policy and Euro-Caspian energy security: The time is now to build the Trans-Caspian Pipeline (June 12, 2020), Atlantic Council, available at <https://www.atlanticcouncil.org/blogs/energysource/us-foreign-policy-and-euro-caspian-energy-security-the-time-is-now-to-build-the-trans-caspian-pipeline/>.

³⁴ *Id.*; see also New American company seeks to realize Trans-Caspian pipe dream (Dec. 1, 2021), available at <https://eurasianet.org/new-american-company-seeks-to-realize-trans-caspian-pipe-dream>.

³⁵ The Curious Case of Central Asia's Severe Electricity Shortages (Nov. 16, 2021), available at <https://www.rferl.org/a/central-asia-severe-electricity-shortages/31564293.html>.

on 96.5% of Chinese exports, while almost 91% of China's imports from Georgia have become tariff-free immediately, with a further 3% covered by 2023.³⁶

Fourth, a regional DFC office would allow the United States to lock-in structural reform and policy adjustment via a physical presence in the region. The combination of a regional DFC office and an FTA provides a framework for the provision of technical assistance from the United States (to include training and transfer of know-how in the form of seminars and workshops) and assistance in the implementation of obligations.

Fifth, a regional DFC office would support the lasting impact of development finance as Georgia continues to privatize SOEs.³⁷ This approach would serve to maximize finance for development, leveraging sources of finance, expertise, and solutions to improve efficiency and strengthen service delivery, which serve as barriers to successful privatizations.³⁸ For example, Uzbekistan's pivot to market liberalism and political openness presented investment opportunities; however, Uzbekistani companies have lacked access to funding.³⁹ The World Bank Group's IFC recently stepped in, signing an agreement to assist the government of Uzbekistan in privatizing leading players in the country's chemicals and fertilizers sector.⁴⁰ Under the agreement, IFC will act as a strategic advisor, with the aim of modernizing the industry and driving greater foreign direct investment and growth.⁴¹ Further, Uzbekistan and the

³⁶ Free Trade Agreement Between The Government of Georgia and the Government of The People's Republic of China, available at http://www.economy.ge/uploads/files/2017/foreign_trade/tavisufali_vachrobis_shetanxmeba_georgia_china/shetankhmeba_2018/page_0_60_145_179_china_georgia_fta_for_georgia.pdf.

³⁷ Acting PM Gakharia: Georgia should plan privatization of several state-owned companies (Dec. 23, 2020), available at <https://agenda.ge/en/news/2020/4002>.

³⁸ Zohrab, John and Halstead, Avril. Georgia – Draft Public Corporation Reform Strategy (Dec. 2021), International Monetary Fund, available at <file:///C:/Users/116940/Downloads/1GEOEA2021009.pdf>.

³⁹ Uzbekistan: From Privatizing Everything To Leapfrogging 30 Years (Jun. 25, 2021), FORBES (“FORBES”), available at <https://www.forbes.com/sites/kenrapoza/2021/06/25/uzbekistan-from-privatizing-everything-to-leapfrogging-50-years/?sh=634647ff124d>.

⁴⁰ IFC to Help Government of Uzbekistan Privatize One of the Key Chemicals Companies (Feb. 2, 2022), IFC – THE WORLD BANK GROUP, available at <https://pressroom.ifc.org/all/pages/PressDetail.aspx?ID=26807>.

⁴¹ *Id.*

DFC have jointly committed to raising \$1 billion over five years to support transformation into a modern, higher tech landscape.⁴² Such investments facilitate Uzbekistan's commitment to lowering the international perception of corruption, improving labor rights, and undertaking environmental, social, and governance standards to attract investment.⁴³ The Uzbekistani example underscores the potential impact of development finance in the context of privatization objectives.

Georgia's trade and investment climate makes the nation the most fitting destination for a DFC office in the region, particularly given the other states' reluctance to directly align with Western interests.⁴⁴ In addition, Georgia is currently ranked seventh in the World Bank's Ease of Doing Business Index.⁴⁵ Georgia's GDP growth was the fastest in the region for 2017 and 2018 at 4.8% a year, with the International Monetary Fund predicting a sustained rate of 5.8% for 2022.⁴⁶ The United States and Georgia work to increase bilateral trade and investment through a High-Level Dialogue on Trade and Investment and through the U.S.-Georgia Strategic Partnership Commission's Economic, Energy, and Trade Working Group.⁴⁷ The United States and Georgia also have signed a bilateral investment treaty (which stipulates Georgia is eligible to export many products duty-free to the United States under the Generalized System of Preferences program),⁴⁸ and a bilateral trade and investment framework agreement.⁴⁹ Notably,

⁴² See FORBES.

⁴³ *Id.*

⁴⁴ See e.g., Nagorno-Karabakh Conflict, Council on Foreign Relations, available at <https://www.cfr.org/global-conflict-tracker/conflict/nagorno-karabakh-conflict>.

⁴⁵ Ease of Doing Business Rankings, THE WORLD BANK, available at <https://www.doingbusiness.org/en/rankings>.

⁴⁶ Georgia, INTERNATIONAL MONETARY FUND (Sept. 2021), available at <file:///C:/Users/116940/Downloads/1GEOEA2021002.pdf>.

⁴⁷ Georgia – Country Commercial Guide, INTERNATIONAL TRADE ADMINISTRATION (Oct. 2021), available at <https://www.trade.gov/country-commercial-guides/georgia-trade-agreements#:~:text=Georgia%20has%20free%20trade%20regimes,an%20FTA%20with%20Hong%20Kong>.

⁴⁸ Georgia Bilateral Investment Treaty (1994), available at <https://2001-2009.state.gov/documents/organization/43561.pdf>.

⁴⁹ Trade and Investment Framework Agreement Between the United States of America and Georgia, available at [https://ustr.gov/sites/default/files/U.S.-Georgia%20TIFA%20\(English\).pdf](https://ustr.gov/sites/default/files/U.S.-Georgia%20TIFA%20(English).pdf).

citing a 2018 study performed by PriceWaterhouseCoopers, former Georgian Prime Minister Kvirikashvili stated: “[i]n case of a Free Trade Agreement between our two countries, according to the recent study performed by PricewaterhouseCoopers, exports of the US goods can grow by 360% in 5 years, creating new jobs in the US.”⁵⁰

Specifically, Georgia presents investment opportunities in infrastructure and trade and logistics to undermine the impact of Chinese BRI transport projects on FDI. Substantial gaps in Georgia’s transport infrastructure remain since its independence.⁵¹ The reliability and efficiency of seaports can be improved and east-west and north-south highways need upgrades and new links.⁵² The rail connections from ports to cities and cities to the border can need to be improved.⁵³ Although Georgia has made significant progress in the area of customs clearance and border-crossing by adopting one-stop shop and a risk-based system, there are opportunities to further reduce border delays.⁵⁴ Georgia’s “soft” infrastructure for trade facilitation and logistics compares well with others in the region, but there is still some way to go to become a strong performer in its border crossings.⁵⁵

It may be argued that the DFC currently finances several projects in the South Caucasus region and therefore, the value-add of a regional DFC office appears to be limited.⁵⁶ Given their proximity to the South Caucasus states, however, Russia and China are the only beneficiaries of the DFC’s absence in the Caucasus region. In addition, total historical DFC investment in the

⁵⁰ Prime Minister Kvirikashvili Endorses PriceWaterhouseCoopers in his Remarks With the U.S. Secretary of State Pompeo (Jun. 2018), available at https://www.pwc.com/ge/en/press-room/assets/2018/PwC_Press_Release_FTA_Final.pdf.

⁵¹ See Georgia Country Case Study.

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ See e.g., 2021 Investment Climate Statements: Georgia, U.S. Department of States, available at <https://www.state.gov/reports/2021-investment-climate-statements/georgia/>.

region pale in comparison to commitments by Russia and China in the region. For example, in 2018, Chinese FDI in the South Caucasus alone exceeded \$800 million.⁵⁷

D. *Corruption And “Debt-Trap Diplomacy” Consequences For Regional Countries Absent Alternative Foreign Investment Sources*

DFC assistance to promote American investment in Georgia’s ports and shipyards will ensure not only an alternative source of investment in critical and strategic infrastructure but will also provide an alternative to Chinese and Russian economic and political influence in the South Caucasus.

Increased corruption is a danger that arises from foreign investment inflows, and its likelihood depends on both the host country’s political and economic environment, as well as the investors’ commitments to transparency. For example, there is reason to believe that the results of the Georgian-Russian investment relationship have reinforced a cycle of corruption and loss of strategic private sector investors.⁵⁸ Approximately 38% of Georgia’s foreign investments come from offshore zones, and in some cases, they were linked to money of Russian origin. More broadly, the South Caucasus states’ current energy security, and natural gas supply, depends on Russia.⁵⁹ The region’s strategic location and attractive domestic policies create a feedback loop reinforcing lopsided relationships where Georgia is overly dependent on Russian and Chinese investors.

Chinese debt is usually guaranteed by the host state or directly secured by strategically important facilities and the privilege of long-term exploitation of natural resources or operations, unlike debt issued by the DFC and World Bank, where lenders work with borrowers to develop

⁵⁷ See RUSSIA MATTERS.

⁵⁸ Governance Matters VII: Aggregate and Individual Governance Indicators 1996-2007, THE WORLD BANK (Jun. 2008), available at <http://info.worldbank.org/governance/wgi/pdf/governancemattersvii.pdf>.

⁵⁹ See e.g., Energy Security in Armenia available at <https://borgenproject.org/energy-security-in-armenia/>.

programs to make debt levels sustainable. When, after completion of an infrastructure project funded by Chinese debt, the host country cannot mobilize the financial and human resources necessary for the uninterrupted and full-fledged operation of a facility, the state forces the transfer of control of these facilities to Chinese creditor banks or Chinese companies.⁶⁰

Therefore, there are risks involved when China finances projects. Some of the countries and entities accepting Chinese lending are default risks and some of the credit that has been extended is extended without due diligence and on terms that are potentially injurious to the borrowers.⁶¹

Conversely, DFC's authorizing legislation, the Better Utilization of Investments Leading to Development (BUILD) Act of 2018, relaxed the traditional 25% minimum U.S. equity requirement and the more recent requirement of a U.S. connection.⁶² The World Bank has conducted a comparison of International Development Association and International Bank for Reconstruction and Development lending terms to Chinese lending terms (interest rates, grace periods, and maturities) over the 2000-2014 time period. The study demonstrates that China's official financing is less concessional than World Bank financing in comparable settings. "Concessional," or the extent to which loans are offered at below-market rates (*i.e.*, low

⁶⁰ China in Africa, INSTITUTE OF DEVELOPING ECONOMIES ("China in Africa"), available at https://www.ide.go.jp/English/Data/Africa_file/Manualreport/cia_11.html; *see also* China's Real 'Debt-Trap' Threat (Dec. 13, 2021), ATLANTIC COUNCIL, available at <https://www.atlanticcouncil.org/blogs/new-atlanticist/chinas-real-debt-trap-threat/>.

⁶¹ *See* China in Africa.

⁶² Mission Creep at the Development Finance Corporation (Sept. 20, 2021), Center for Strategic & International Studies, available at <https://www.csis.org/analysis/mission-creep-development-finance-corporation>; *see also* Debunking the Myth of 'Debt-Trap Diplomacy' How Recipient Countries Shape China's Belt and Road Initiative (Aug. 2020), available at <https://www.chathamhouse.org/sites/default/files/2020-08-25-debunking-myth-debt-trap-diplomacy-jones-hameiri.pdf>.

interest rates, long maturities, and extended grace periods) reduces the likelihood of a debt crisis in borrower countries, and concessional lending policies.⁶³

While Chinese investments in the South Caucasus are relatively new, there are many examples of the grave consequences of China's credit policy, and the number of countries at risk of partial loss/concession of sovereignty due to Chinese debt increases from year to year. Irresponsible lending and unchecked or corrupt borrowing could leave countries so indebted to China that they could be forced to make onerous concessions down the line on terms to which those who made the agreement would never have originally consented. Recognizing these challenges, some countries – including Indonesia, the Philippines, Thailand, Nepal, Myanmar, Pakistan, Kenya, Zambia, and Sierra Leone, among others – have reconsidered or even reneged on borrowing or project arrangements with China.⁶⁴

There are cases where China demands land or other state assets in exchange for debts (as in the case of Tajikistan), a seaport to realize its specific strategic economic interests (as in the case of Sri Lanka), or both economic and military concessions (as in the case of Pakistan). The risk of debt-trap diplomacy is compounded by China's authoritarian political model, which allows the state to exercise far more leverage over companies and imposes fewer legal hurdles in dictating the conditions under which they operate.

E. *Support For Democracy And Sustainable U.S. Policy*

The United States also has an interest in promoting democratic practices and protection of labor, environment, and good governance standards, in addition to increasing regional market transparency. U.S. involvement in the South Caucasus has played a very important role in its

⁶³ Chinese and World Bank Lending Terms: A Systematic Comparison Across 157 Countries and 15 Years (Apr. 2020), THE WORLD BANK, available at <https://www.cgdev.org/sites/default/files/chinese-and-world-bank-lending-terms-systematic-comparison.pdf>.

⁶⁴ See NATO.

progress at critical times. Those initiatives, however, lacked adequate resources, including material support and a clear vision of U.S. interests in the region.⁶⁵

A regional DFC office would help resolve obstacles to progress. First, adherence to labor, environment, and general good governance standards is achieved by providing financing for private firms and requiring borrowers to adhere to national labor laws and international labor standards (*e.g.*, World Bank International Finance standards for labor conditions in project finance) in their operations.⁶⁶ Generally, “DFC investments adhere to high standards and respect the environment, human rights, and worker rights.”⁶⁷

Second, a regional DFC office and financing would facilitate ongoing discussions to improve the regional business climate to attract more quality investment, underscoring the importance of continued improvements in rule of law, protecting intellectual property rights, and resolving business disputes in a transparent and timely manner in line with Western values.

Further, U.S. policy seeks to finance development that “provides for public accountability and transparency,” including corporate transparency.⁶⁸ Accordingly, DFC has certain statutory responsibilities to engage both Congress and the public about its activities and policies and Congress has also established several measures to facilitate public access to information about DFC. Therefore, U.S. policy and the transparent nature of development finance jointly enable

⁶⁵ U.S. Policy Toward the South Caucasus: Take Three (May 31, 2017), available at <https://carnegieendowment.org/2017/05/31/u.s.-policy-toward-south-caucasus-take-three-pub-70122>.

⁶⁶ For example, in 2020, Georgia’s parliament adopted sweeping amendments to the country’s labor code. The reforms regulate such crucial issues and strengthen the labor inspectorate by granting it more independence and widening its mandate. Georgia’s Parliament adopts historic labour law reform package (Sept. 29, 2020), available at https://www.ilo.org/moscow/news/WCMS_758336/lang--en/index.htm.

⁶⁷ DFC – Who We Are, available at <https://www.dfc.gov/who-we-are#:~:text=U.S.%20International%20Development%20Finance%20Corporation,facing%20the%20developing%20world%20today>.

⁶⁸ 22 U.S.C. §9611; Sec. 1411 of the BUILD Act.

the United States to acquire information, including on impact and mobilization, to assess the market, risks, and opportunities.

In addition to offering new commercial opportunities for U.S. firms, a regional DFC office serves to support U.S. values in open markets, good governance, transparency, and environmental safeguards, as a counterweight to more proximate adversaries, such as Russia and China.

Finally, a DFC office would support those countries in the south Caucasus that are shifting their policies away from Russia and China and to the West. For example, Georgia's recent application to accede to the European Union showcases Georgia's intent to pursue democratic reforms.⁶⁹ The EU accession process provides a concrete framework to solidify Georgia's existing laws and practices, as well as anticipated reforms, in the areas of trade, governance, and human rights.⁷⁰ In this critical period for the South Caucasus, a DFC office can accelerate the region's turn to the West.

III. THE NEW GEOPOLITICAL REALITIES OF THE SOUTH CAUCASUS

A. *Introduction*

Thirty years after the Soviet Union's collapse, the geopolitical boundaries that once marked its former republics remain in flux. In particular, the South Caucasus states have developed a web of relationships with the countries to their south, west, and east against a backdrop of diminishing engagement from the United States and the European Union. The capitals of the three South Caucasus states are geographically closer to the economic and political power centers of Russia and Turkey than they are to the United States. Given the

⁶⁹ "Georgia Formally Applies for EU Membership," Deutsche Welle (Mar. 3, 2022), available at: <https://www.dw.com/en/georgia-formally-applies-for-eu-membership/a-61001839>.

⁷⁰ "Georgia's EU Questionnaire Made Public," Civil.ge (Apr. 15, 2022), available at: <https://civil.ge/wp-content/uploads/2022/04/Georgias-EU-Questionnaire.pdf>.

region's proximity to Russia and Turkey, interactions with these two countries continue to develop considerably.

The strategic location of the South Caucasus at a crossroads between Russia and Turkey, the Caspian and the Black Seas, has continued to attract Russia's political, military, and economic ambitions. In addition, Turkey's influence in the Caucasus region is solidifying through significant FDI. As long as Turkey maintains strong ties to the West and shared concerns about Russia — including through NATO — the situation remains in line with U.S. security interests. President Erdogan's pattern of building influence through illiberal policies and related soft power, however, could undermine U.S. regional interests. China's Free Trade Agreement with Georgia, which entered into force in 2018,⁷¹ in addition to its bilateral investment treaties with Azerbaijan and Armenia,⁷² reflect its political and economic interests in the South Caucasus region.

The backdrop of Russia's full-scale military invasion of Ukraine provides a strong strategic context for opening a regional DFC office in the South Caucasus region. The establishment of a permanent U.S. DFC office in the region is a critical element of strengthening U.S. ties throughout the region by shoring up the economic and political stability of allies while balancing, and displacing where possible, the influence of our adversaries. Establishing a regional DFC office would further a "whole-of-government effort to assess how to better use the U.S. Government's development infrastructure toolkit," which "includes direct financing tools of the DFC...." Given the geopolitical realities, the provision of transparent and sustainable financing through a permanent regional DFC office would ensure a values-driven and high-

⁷¹ China FTA Network, MOFCOM (accessed Mar. 3, 2022), available at <http://fta.mofcom.gov.cn/topic/engeorgia.shtml#:~:text=Preferential%20Trade%20Agreement&text=The%20China%2DGeorgia%20FTA%20negotiations,has%20completed%20in%20Eurasia%20region>.

⁷² China, United Nations UNCTAD, available at <https://investmentpolicy.unctad.org/international-investment-agreements/countries/42/china>.

standard Build Back Better World for the creation of meaningful and sustainable regional partnerships.

B. *Russia's Military Influence Facilitates The Kremlin's Geopolitical Objectives*

President Vladimir Putin has treated the South Caucasus and the broader region as an integral part of Russia's natural sphere of influence, in which Russia seeks to maintain leverage over the region's foreign policy trajectory. Over the past several years, Russia has shifted from the use of conventional military means to hybrid tools that aim to reestablish the Kremlin's influence over the broader region.

This approach follows the Russia-Georgian War in 2008, when Russian troops invaded Georgian territory. Georgia's anti-Kremlin and pro-Western foreign policy agenda has led the Kremlin to review its strategy and mobilize hybrid tools. These tools include discrediting the West in the opinion of the Georgian public and reversing Georgia's European and Euro-Atlantic agenda.⁷³ The Kremlin has since turned Georgia's occupied regions into military bases by deploying modern offensive weapons and stationing groups on the ground. Some of these troops are near the main Georgian east-west highway and critical infrastructure such as pipelines that transit oil and natural gas from the Caspian Basin to the West.⁷⁴

Even before Russia's invasion of Ukraine, it demonstrated its readiness to engage militarily to support its geopolitical agenda. In January 2022, Russia sent troops into Kazakhstan.⁷⁵ There has been an increase in military hostilities between Armenia and Azerbaijan in Nagorno Karabakh, just as envoys from Armenia and Turkey their first rounds of talks on political normalization in Moscow on January 14, 2022.⁷⁶ Russia's interventions in

⁷³ Russia's "Hybrid Aggression" Against Georgia: The Use of Local and External Tools, CSIS (Sept. 21, 2021), available at <https://www.csis.org/analysis/russias-hybrid-aggression-against-georgia-use-local-and-external-tools>.

⁷⁴ *Id.*

⁷⁵ *See* Russia-Led Bloc.

⁷⁶ Armenia, Azerbaijan: Further sporadic violence likely along Azerbaijan and Armenia border in coming months following fatal violence Jan. 11 (Jan. 14, 2022), available at

Ukraine in 2014 and 2022 intended to diminish the influence of the West, including the United States and the European Union, and especially NATO.⁷⁷

Russia's military deployments in the post-Soviet space are designed to entrench its influence as the dominant external power in the region and to prevent or limit the influence of other external powers, such as the United States.

As in the case of Ukraine, Russia's most important motives for engagement in the South Caucasus are geopolitical. Russian foreign policy from 2000 onward commits to a revival of Russian power and influence in its "near abroad." This clearly encompasses the North and South Caucasus, which Moscow views as a unified geographic interest. Accordingly, the Caucasus region has regained its traditional salience in the spectrum of Russian security concerns.

C. The Expansion Of China's Adversarial Economic Influence And Political Capital

On the economic front, energy pipelines and transportation corridors through the South Caucasus region have opened Caspian resources and provide opportunities to change geopolitical dynamics with Russia and Turkey. Strategic competitors, including China, use increased investments in the Caucasus and Central Asia to expand their economic influence and political capital in the region.

Although geographically distant, China has pursued various opportunities with infrastructure projects across the South Caucasus. Beijing has provided sizable funds for transit infrastructure, digital infrastructure, and other projects in Azerbaijan, Armenia, and Georgia.⁷⁸ China's diplomatic and economic activity in Belarus, Ukraine, Moldova, Azerbaijan, Armenia,

<https://crisis24.garda.com/alerts/2022/01/armenia-azerbaijan-further-sporadic-violence-likely-along-azerbaijan-and-armenia-border-in-coming-months-following-fatal-violence-jan-11-update-8>.

⁷⁷ How NATO's expansion helped drive Putin to invade Ukraine (Feb. 24, 2022), NPR, available at <https://www.npr.org/2022/01/29/1076193616/ukraine-russia-nato-explainer>.

⁷⁸ South Caucasus and Central Asia: The Belt and Road Initiative Georgia Country Case Study (Jun. 2020) ("Georgia Country Case Study"), THE WORLD BANK ("THE WORLD BANK"), available at <https://openknowledge.worldbank.org/bitstream/handle/10986/34122/South-Caucasus-and-Central-Asia-The-Belt-and-Road-Initiative-Georgia-Country-Case-Study.pdf?sequence=4&isAllowed=y>.

and Georgia has grown since the end of 2013 with the launch of the BRI because Beijing rightly sees the region as a trans-continental link between Asia and Europe.⁷⁹

Beijing has employed various public and private financial institutions— Asian Infrastructure Investment Bank, China Development Bank, Exim Bank, Bank of China, Industrial and Commercial Bank of China— to invest in projects of strategic significance. China's strong local presence challenges Western political, infrastructure, and trade interests in the Caucasus. China's BRI is an ambitious multi-year effort to increase influence by improving international transport infrastructure and increasing economic integration. Notably, two BRI corridors pass through the Caucasus and connect China to Europe and China to Iran and West Asia, respectively, through five strategic routes.⁸⁰

China's interests in the region are not limited to economic engagement. There is a clear military dimension to the BRI. China is building a network of ports, many of which could serve both commercial and military logistics support functions.⁸¹ China currently owns and operates or plans to own and operate ports in Burma, Bangladesh, Pakistan, Sri Lanka, Djibouti, Egypt, Israel, Turkey, Greece, Italy, Spain, Morocco, France, Belgium, and the Netherlands.⁸² China has developed relations with all countries in the region instead of taking a side in regional conflicts.⁸³ This allows China to continue growing its presence in all countries of the region, a process that still coincides with Russia's interest in pushing the region away from the West.

1. China – Azerbaijan

⁷⁹ China Regional Snapshot: Eastern Europe & The South Caucasus, U.S. House Foreign Affairs Committee - Republicans, available at <https://gop-foreignaffairs.house.gov/china-regional-snapshot-eastern-europe-the-south-caucasus/>.

⁸⁰ See THE WORLD BANK.

⁸¹ See China's Belt and Road Initiative: A Strategic and Economic Assessment, NATO (Nov. 2020), available at <https://www.nato-pa.int/download-file?filename=/sites/default/files/2020-11/033%20ESC%2020%20E%20rev.1%20fin%20-%20CHINA%20BRI%20A%20STRATEGIC%20AND%20ECONOMIC%20ASSESSMENT.pdf>.

⁸² *Id.*

⁸³ *Id.*

In Azerbaijan, Beijing has provided substantial investment for transit, digital, natural resource, and non-oil sector projects. As China develops its overland trade route, it has invested in upgrading the port of Baku and the Baku-Tbilisi-Kars railroad.⁸⁴ In parallel, Beijing signed an economic package worth \$821 million with Baku to extend its reach to the non-oil sectors.⁸⁵ The deal includes the development of chemical industrial parks, agricultural industrial parks, and greenhouse complexes.⁸⁶

Azerbaijan's economic diversification policy and China's willingness to transfer industrial capacity are facilitating greater economic cooperation between the two countries. Since 2018, several large-scale Chinese projects have been launched in Azerbaijan: a \$1.5 billion industrial park at Alyat Port, a \$1.17 billion integrated steel plant, a \$300 million tire factory, and a lead recycling plant.⁸⁷ Moreover, with Chinese assistance, within the framework of Azerbaijan's Digital Hub Initiative, an Asia-European telecommunication corridor will be established to complement the Digital Silk Road connecting Mumbai to Frankfurt via Azerbaijan.⁸⁸

Beijing has also cultivated collaboration with Baku in the military and defense fields. The two countries signed an agreement on mutual military aid and the purchase of Chinese arms, which lays the groundwork for deeper military cooperation.⁸⁹ Notably, a December 2019 NATO

⁸⁴ The Belt and Road Initiative – the New Silk Road: A Research Agenda (Feb. 26, 2019), available at <https://www.tandfonline.com/doi/full/10.1080/24761028.2019.1580407>.

⁸⁵ Azerbaijan and China Sign \$800 Million Economic Package: The Geo-Economic Implications (May 29, 2019), available at <https://jamestown.org/program/azerbaijan-and-china-sign-800-million-economic-package-the-geo-economic-implications/>.

⁸⁶ *Id.*

⁸⁷ In the Caspian Region, China is Just Getting Started (Feb. 27, 2021) (“China is Just Getting Started”), available at <https://carnegiemoscow.org/commentary/83950>.

⁸⁸ Another route from China to Europe in the South Caucasus (Apr. 29, 2021), available at <https://bakutribune.com/en/news/455/another-route-from-china-to-europe-in-the-south-caucasus>.

⁸⁹ Azerbaijan Through the Prism of BRI: China's Mounting Interests and Influence in the Region (Oct. 28, 2019), available at <https://www.ponarseurasia.org/azerbaijan-through-the-prism-of-bri-china-s-mounting-interests-and-influence-in-the-region/>.

declaration underlines that “China’s growing influence and international policies present both opportunities and challenges that we need to address together as an Alliance.”⁹⁰

2. China – Armenia

China’s presence is also on the rise in Armenia, where the number of Chinese companies operating grew from five in 2016 to 13 in 2020.⁹¹ A number of Chinese companies have purchased stakes in Armenian companies in preparation to modernize production, particularly in copper and textiles, the two largest Armenian exports to China.⁹²

China has in recent years provided military assistance to Armenia and sent high-level military delegations to Georgia.⁹³ Trade with China has also greatly increased over the past decade. In 2020, China was the third largest trading partner by exports with 11.5% (\$289 million) of Armenia’s exports and the second largest trading partner by imports with 14.5% (\$663 million) of Armenia’s imports.⁹⁴ These numbers are a major increase from 2010 when China only made up 3.1% (\$30 million of Armenia’s exports and 10.6% (\$402 million) of Armenia’s imports.⁹⁵

3. China – Georgia

Considering Georgia’s increasing capacity as a transit country, China has provided substantial resources for the country’s strategic and infrastructure projects. The BRI’s goal of improving transport connections and greater economic integration is to be achieved through

⁹⁰ London Declaration, NORTH ATLANTIC TREATY ORGANIZATION (Dec. 2019) (“London Declaration”), available at https://www.nato.int/cps/en/natohq/official_texts_171584.htm.

⁹¹ See China is Just Getting Started.

⁹² *Id.*

⁹³ China’s Soft Power in the South Caucasus (Mar. 2, 2020), available at <https://www.cacianalyst.org/publications/analytical-articles/item/13604-chinas-soft-power-in-the-south-caucasus.html>.

⁹⁴ Annual International Trade Statistics by Country: Armenia (Nov. 14, 2021), available at <https://trendeconomy.com/data/h2/Armenia/TOTAL>.

⁹⁵ Armenia Product Exports and Imports to China 2010, World Integrated Trade Solution, available at <https://wits.worldbank.org/CountryProfile/en/Country/ARM/Year/2010/TradeFlow/EXPIMP/Partner/CHN/Product/all-groups>.

substantial Chinese financing of transport and complementary infrastructure in the BRI countries, better policy coordination among those countries, and larger flows of outward FDI from Chinese private firms and SOEs.

Since the early 2000s, Beijing has invested considerably in Georgia's hydropower plants, ground transportation networks, railroads, seaports, and free industrial zones. China has invested a significant amount of money in Georgia's hydropower infrastructure.⁹⁶ In the mid-2000s, China funded the construction of the Khadori (or "Khudoni") Hydropower Plant in Georgia's Pankisi Gorge.⁹⁷ Recent Chinese projects also include a \$160 million gas-to-electricity plant; the country's longest tunnel, expected to be part of China's Eurasian rail network; the Mindeli coal mine in Tkibuli; and the country's largest glass bottle production line, which is currently under negotiation.⁹⁸

There is also a noticeable rise in Chinese investors' interest in Georgia. For example, the China Energy Company limited, an SOE, has purchased three-quarters of the Poti Industrial Free Zone, the largest free zone in Georgia and most substantial in terms of business volumes being handled.⁹⁹

4. Conclusion

For over a decade, China has been improving its position in the Caucasus by investing, giving non-repayable loans and enhancing trade relations, which facilitate its soft power in the region and present a risk of debt-trap diplomacy, as discussed in detail below. Years of strong dependency on China and a clear escalation of Chinese assertiveness in the region require an alternative aligned with U.S. regional and economic interests.

⁹⁶ U.S. Should Keep an Eye on Rising Chinese Investment in the South Caucasus (Oct. 1, 2020), RUSSIA MATTERS, available at <https://www.russiamatters.org/analysis/us-should-keep-eye-rising-chinese-investment-south-caucasus>.

⁹⁷ See THE WORLD BANK.

⁹⁸ See China is Just Getting Started.

⁹⁹ Chinese Corporation to Purchase 75% of Poti Free Industrial Zone Shares, AGENDA.GE (Jan. 2017), available at <https://agenda.ge/en/news/2017/9>.

D. *Turkey's Rising Influence Allows Ankara To Further Expand Its Ambitions In Eurasia*

In 2016, Turkish President Recep Tayyip Erdogan declared that “Turkey is not just Turkey,” adding that Turkey is “responsible to the hundreds of millions of our brothers in the geographical area to which we are connected by historical and cultural ties.”¹⁰⁰

The escalation of conflict between Azerbaijan and Armenia in Nagorno-Karabakh and the armistice brokered by Moscow exposed the potential results of the West’s inattention in the South Caucasus. For Turkey, the war was a showcase for Ankara’s growing role in the strategically important South Caucasus. Turkey’s most significant contribution to Azerbaijan’s victory was three decades of meticulous development of military capacity.¹⁰¹ Turkey is also Azerbaijan’s third-largest supplier of military equipment after Russia and Israel.¹⁰² The visible absence of the United States in the conflict and peace process led local powerbrokers to regionalize the conflict, form alternative political processes, exclude the West, and avoid traditional multilateral frameworks.

Turkey’s growing influence in the Caucasus can be shown by its development into a regional energy transit hub. The oil and gas pipelines that run from Azerbaijan to Turkey transit Georgia.¹⁰³ According to the U.S. Energy Information Administration (“EIA”), “Turkey is an increasingly important transit hub for oil and natural gas supplies as they move from Central Asia, Russia, and the Middle East to Europe and other Atlantic markets.”¹⁰⁴ In June 2018, with

¹⁰⁰ The United States Must Counter Turkey’s Rising Influence in Georgia, THE GLOBE POST (Oct. 24, 2019), available at <https://theglobepost.com/2019/10/24/turkey-influence-georgia/>.

¹⁰¹ Turkey’s Overlooked Role in the Second Nagorno-Karabakh War (Jan. 21, 2021) (“Turkey’s Overlooked Role”), available at <https://www.gmfus.org/news/turkeys-overlooked-role-second-nagorno-karabakh-war>.

¹⁰² AP Explains What lies behind Turkish support for Azerbaijan (Oct. 2, 2020), available at <https://apnews.com/article/turkey-territorial-disputes-azerbaijan-ankara-armenia-9a95d9690569623adedffe8c16f3588d>.

¹⁰³ See Turkey’s Overlooked Role.

¹⁰⁴ See THE GLOBE POST.

the Trans-Anatolian Natural Gas Pipeline (“TANAP”), Ankara gained control of the Southern Gas Corridor (“SGC”) that carries gas from the Caspian Basin into Southeastern Europe.¹⁰⁵

President Erdogan’s approach in the South Caucasus has followed a well-established pattern of building influence by investing in networks of pro-Turkish public organizations.¹⁰⁶ As long as Turkey maintains strong ties to the West, and shares concerns about Russia, the situation remains in line with U.S. security interests. Evolutions in Turkish illiberal politics and soft power projection, however, present potential concerns for the United States.¹⁰⁷

IV. CONCLUSION

The DFC has a successful track record of investment in the South Caucasus region and understands how to leverage sophisticated domestic financial markets for regional investment. By opening a regional office in Georgia, the DFC can address regional development finance and infrastructure needs while displacing competing and adverse geopolitical interests by offering a better alternative through transparent and sustainable financing.

¹⁰⁵ Turkey, U.S. ENERGY INFORMATION ADMINISTRATION (Feb. 2, 2017), available at <https://www.eia.gov/international/analysis/country/TUR>.

¹⁰⁶ See THE GLOBE POST.

¹⁰⁷ Religious Soft Power in the South Caucasus: The Influence of Iran and Turkey, BROOKINGS (Dec. 2018), available at <https://www.brookings.edu/blog/order-from-chaos/2018/12/13/religious-soft-power-in-the-south-caucasus-the-influence-of-iran-and-turkey/>.